



Directorate of
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International
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Weekly

8 April 1983

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Comments and queries regarding this publication are welcome. They may be directed to [redacted] Directorate of Intelligence [redacted]

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**International
Economic & Energy
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Synopsis

Perspective—South America: Managing Financial Crisis

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The payments problems besetting Brazil and Venezuela illustrate continuing tensions that confront the international financial system. We believe that Washington will likely be caught in the middle. Debtors will probably turn to the US Government for direct financial assistance, while creditors will likely insist that Washington press the debtors to sustain politically unpopular adjustment programs.

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Brazil: Bleak Economic Prospects

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Brazil continues to face foreign exchange difficulties despite the conclusion of new loan agreements. The government is now making the adjustments required to retain crucial bank support, but, with the austerity program already drawing fire, it is likely to waver and fail to meet all IMF targets.

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Venezuela: Worsening Economic Outlook

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The government's unwillingness to adopt a strict adjustment program has left international bankers reluctant to cooperate in refinancing Caracas's large external debt. To regain banker support, we believe that Venezuela will ultimately resort to the IMF this year.

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Spain: Socialist Economic Policy

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The Socialist government has proposed a conservative economic program for 1983 and will do little to promote economic recovery. Registered unemployment probably will continue to grow and may approach 20 percent by the end of 1983.

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Protectionist Trends in Developing Countries

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Most LDCs have traditionally relied on import barriers to protect emerging industries. Currently, many LDCs are increasing barriers to imports in an attempt to deal with burgeoning debt problems.

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The Philippines: Economic Decisionmaking

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The Philippines's economic decisionmaking system has been geared to striking a politically acceptable balance between the views of Western-educated technocrats, creditors such as the IMF and the World Bank, and influential domestic business interests. The balance currently favors the technocrats and creditors, chiefly because Marcos recognizes that the economy is in its worst shape in a decade.

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Perspective

South America: Managing Financial Crisis

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The payments problems besetting Brazil and Venezuela illustrate the continuing tensions that confront the international financial system. Brasilia faces difficulties in servicing its \$85 billion foreign debt, despite the disbursement of new loans last month. Caracas has recently declared a postponement on maturing public-sector principal payments through the middle of the year because of the breakdown in its refinancing program.

Brasilia's failure to adjust its economy after the successive oil shocks in the 1970s is at the root of its problems. The government resorted to heavy foreign borrowing to sustain the growth perceived as necessary to prevent social unrest. By and large, the borrowing program was well managed and Brazil's debt servicing record is impressive. Easy access to foreign credit, however, undermined the incentives to take the tough, unpopular steps necessary to defeat triple-digit inflation, root out external imbalances, and sweep away the inefficiencies plaguing the economy.

Caracas is now paying the price for blatantly poor economic management. This year, for example, it has been lax in meeting debt payments and has yet to define exchange controls announced in late February. These problems are symptomatic of persistent bumbling in development planning. Despite a large investment program facilitated by the oil bonanza, Caracas has been unable to diversify its economy. It also has failed to implement necessary economic reforms, devise an effective debt restructuring program, and provide incentives needed to develop a strong private business sector. We anticipate—based on solid evidence from international bankers—that the economic team will have difficulty pursuing needed stabilization measures.

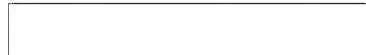
In these—as well as other South American countries—the major unknown remains how the IMF and commercial bankers will react to the failure of debtors to meet their stabilization targets. If creditors demonstrate reluctance to continue lending, the rescue programs will quickly unravel. Lacking reserve cushions and with exports still depressed, most debtors will have little choice but to move unilaterally to relieve financial strains. The pattern is already set:

- Chile suspended debt payments in early January after bankers cut credit.
- In early March Argentina announced a postponement in meeting some debt repayments, while Peru declared an extension of maturing short-term credits.
- Uruguay recently announced a 90-day delay in principal payments as a prelude to formal debt rescheduling.
- Brazil is now running commercial arrears because bankers remain reluctant to provide standby financial support.

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These events suggest that—at least implicitly—a “debtors’ revolt” is already under way. South American countries have already rewritten most of the time-honored repayment rules by unilaterally suspending payments. Bankers will not be the only commercial parties affected. Major debtors, especially Brazil, also are pressing suppliers for more liberal terms. Moreover, they are looking to new barter trade deals and increased intraregional trade to ease their payments stringencies, mainly at the expense of developed country exporters.

Under these conditions, we believe that Washington probably will be caught in the middle. Debtors probably will turn to the US Government for direct financial assistance, help in backing efforts to secure additional financing from banks, and new initiatives to reschedule official credits. They will also look to increase exports to the United States. Creditors, on the other hand, probably will insist that Washington press the debtors to sustain politically unpopular adjustment programs. They also probably will seek greater official assistance in meeting debtors’ new money requests and will lobby for more expansionary policies in the developed world.



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Secret**Briefs****Energy****OPEC Oil Production**

OPEC's first-quarter crude oil production of 15.6 million b/d was off 22 percent from year-earlier levels. March output of about 15 million b/d—essentially unchanged from February—reflected the continuing weak demand for OPEC oil. After a surge late in the month, Saudi production averaged about 3.3 million b/d; output early in March was below 3 million b/d. This increase probably represents delays by customers in purchasing crude until announcement of the OPEC price cut; the late-month increase in demand is unlikely to carry over into April.

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OPEC: Crude Oil Production*Million b/d*

	1982	1983 Quota	1983 ^a			
			Jan	Feb	Mar	1st Qtr
Total	18.8	17.5	16.9	14.9	14.9	15.6
Algeria	0.6	0.725	0.7	0.6	0.6	0.6
Ecuador	0.2	0.2	0.2	0.2	0.2	0.2
Gabon	0.2	0.15	0.2	0.2	0.2	0.2
Indonesia	1.3	1.3	1.1	1.0	1.2	1.1
Iran	2.3	2.4	2.7	2.6	2.4	2.6
Iraq	1.0	1.2	0.8	0.8	0.8	0.8
Kuwait	0.7	1.05	0.6	0.8	0.8	0.7
Libya	1.2	1.1	1.4	1.2	1.2	1.3
Neutral Zone	0.3	^b	0.3	0.2	0.2	0.2
Nigeria	1.3	1.3	0.8	0.7	0.9	0.8
Qatar	0.3	0.3	0.3	0.2	0.2	0.2
Saudi Arabia	6.3	^c	4.6	3.7	3.3	3.9
UAE	1.2	1.1	1.1	1.0	1.1	1.1
Venezuela	1.9	1.675	2.1	1.8	1.8	1.9

^a Preliminary.^b Neutral Zone production is shared about equally between Saudi Arabia and Kuwait and is included in each country's production quota.^c Saudi Arabia has no formal quota; will act as swing producer to meet market requirements.

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Buyer uncertainty also dropped Iranian production to 2.4 million b/d despite the cut in official prices to \$28 per barrel for Iranian Light. Iranian production could go lower because the current price differential of only \$1 per barrel between Tehran's crudes and Arab Light may not be sufficiently attractive to maintain sales. Nigeria increased its production to 900,000 b/d but continued to have difficulty selling oil as buyers waited for further price developments. If sales fail to pick up soon, high levels of oil in storage could begin to hamper Nigerian operations. [redacted]

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*Saudis Cut
Pipeline Fees*

Riyadh has cut in half the 50 cents per barrel transit fee it charges for Arab Light crude oil delivered to the Red Sea via Petroline, its cross-country pipeline. The original fee has long been considered excessive, and most customers have refused to accept deliveries from the Red Sea port of Yanbu since early in the year. The United States Liaison Office in Riyadh estimates average throughput for the pipeline is currently about 300,000 b/d—one-sixth its capacity—forcing Petroline to cease operations recently for one- to two-week periods when the line's minimum flow rate of 450,000 b/d could not be sustained. The new 25 cents per barrel fee still may not be enough to generate increased Red Sea liftings, however, because the majority of Saudi crude oil now goes to the Far East. Stiff price competition from higher quality African and North Sea crudes have effectively pushed Saudi oil out of the European market. [redacted]

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*West German
Decision on Soviet
Gas Postponed*

West Germany has again delayed exercising its option as to its willingness to purchase the maximum volume of Soviet gas that was provided for in contracts initialed in November 1981. Last year, natural gas consumption in West Germany declined by 7 percent, and Embassy commercial sources continue to believe there is no demand in West Germany for the full 10.5 billion cubic meters of gas originally under contract. Given the postponement, any further decision by the West Germans to exercise their option to reduce volumes by 20 percent will now be delayed until October at the earliest. Because of declining oil prices and potentially higher economic growth, the West Germans are probably keeping this option open to determine the extent to which gas demand recovers. If pressed on the issue by the Soviets, however, the German purchasers are likely to immediately exercise their options to reduce the volumes taken on a permanent basis. [redacted]

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Secret***Big Seven Electricity Consumption Falls***

Sluggish economic growth in the Big Seven was primarily responsible for an unprecedented 1.4-percent decline in total electricity consumption in 1982. Electricity use in the United States and the United Kingdom dropped by 2.7 and 2.0 percent, respectively. Some modest economic growth in France and Japan led to a slight increase in electricity demand. Most industry analysts now expect electricity demand to return to previous growth rates as the economic recovery gains momentum.

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Big Seven: Electricity Consumption*Billion Kilowatt-hours*

	1979	1980	1981	1982
Total	4,012.2	4,060.2	4,107.1	4,050.8
Canada	322.0	339.4	344.7	344.1
France	235.4	248.7	258.3	261.3
West Germany	349.5	351.4	352.7	350.3
Italy	174.7	180.2	179.2	179.6
Japan	580.0	579.7	569.7	575.5 ^a
United Kingdom	279.5	266.4	258.7	253.6
United States	2,071.1	2,094.4	2,143.8	2,086.4

^a Estimated.

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New Chinese Coal Project

China and Occidental Petroleum probably will reach a final agreement by July to develop the Pingshuo open pit coal mine; an interim agreement was signed in March following completion of a feasibility study. Financial arrangements with the US institutions backing the project are the only remaining obstacles. Occidental is funding 52 percent of the costs and will sell its share of the coal back to the Chinese, who intend to export it. China will use its own share domestically.

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The Pingshuo coal mine will use large-scale extraction equipment imported from the United States and could produce 15 million tons of coal annually by 1987 if construction begins next year. Two additional mines in the same field could eventually add another 20-25 million tons of coal, making the Pingshuo complex one of China's largest coal producers. China currently ranks third in the world in coal production, with an output last year of 650 million tons.

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*Australian-Japanese
LNG Project Delayed*

Because of declining projections of future gas demand, Japanese firms have decided to delay the \$2.5 billion Northwest Shelf liquefied natural gas export project—the second delay in two years. Japanese projections of 1990 gas demand have fallen by 15 percent since 1980. Preliminary engineering work on the project, which was to have begun late last year, will probably not get under way until at least 1984

the plant will not be completed until 1990 at the earliest—three years later than the original completion date.

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The delay will cost Australia nearly \$1.5 billion a year in export revenues at current world prices. It is unlikely, however, the project will be scrapped.

*France Relaxes
Inventory Requirements*

France has lifted a two-year-old policy that requires oil companies to maintain extra distillate and gasoline stocks above the compulsory 90-day level. The requirement was instituted in late 1980 in response to the outbreak of the Iran-Iraq war. According to a press report, the action was taken to reduce the French trade deficit. These extra stocks reportedly amount to less than 22 million barrels. French oil import demand would be reduced by more than 100,000 b/d if the excess is drawn down over a six-month period.

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International Trade and Finance

*Renewed Soviet
Grain Buying*

The USSR reentered the world grain markets last week, buying up to 3.5 million tons of grain. The Soviets purchased 500,000 tons each of Canadian barley and EC wheat; 2 million tons of corn and sorghum from Argentina; and 200,000 tons of US corn.

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Grain traders had anticipated that the Soviets would be buying to fulfill purchase commitments made earlier under various long-term grain agreements and to ensure steady deliveries this spring. As a result, the market has taken the reports in stride. If all reports are accurate, the buying brings total Soviet grain purchases for the marketing year ending 30 June to 34-36 million tons. It now looks as though total purchases from the United States will be little more than the 6 million tons of grain stipulated under the US-USSR long-term grain agreement—far short of the 15.4 million tons purchased last year.

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*Japanese Improving
COCOM Enforcement*

The Japanese have told US officials that Tokyo is moving to improve enforcement of restrictions on exports of high technology to Communist countries. Special funds have been allocated to upgrade liaison among the ministries and government agencies charged with enforcing COCOM restrictions and to retrain personnel directly involved. Tokyo plans to increase public awareness of the restrictions by publishing a handbook on arms control and COCOM lists. The Japanese also have indicated a willingness to discuss enforcement questions with the United States more often and to support a meeting this year of the COCOM Subcommittee on Export Controls. These moves are part of Tokyo's continuing efforts to satisfy US concerns about Japanese export control procedures. For the most part, they are in direct response to suggestions made by US official visitors. A stricter policy on entrance visas for visiting Soviet technical delegations is another example of Tokyo's growing sensitivity to US appeals.

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The extent to which these moves will stem the flow of strategic technology to the USSR and China is unclear. The Trade Ministry's apparent willingness to cooperate could improve Japanese performance. On the other hand, the Japanese have made no mention of expanding the role of the National Police. The National Police monitors the involvement of Soviet intelligence services in illegal trade and scientific and technical collection. It also is partly responsible for investigating trade violations.

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*EC Steel Capacity
Begins To Decline*

According to EC Industry Commissioner Davignon, the EC steel industry has cut its capacity by nearly 10 million tons since 1980, from around 203 to 193 million tons. This is the industry's first significant retrenchment since the steel crisis began in 1975. It is also the first evidence that years of financial losses and EC Commission pressure on the steel companies to reduce their excess capacity may finally be having some effect. Meanwhile, the US steel industry is beginning to trim down, reducing capacity from 139 to 136 million tons last year.

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There is little doubt that the trend toward a smaller steel industry will continue. West Germany has announced a plan to cut about 14 million tons of capacity if the EC Commission will authorize a subsidy payment of about \$1 billion to its steel industry. After a survey of current planning by the major producers, a leading private steel analyst has predicted that the EC and US steel industries together will scrap 15 to 20 percent of their combined capacity by the mid-1980s. Despite this loss, however, capacity will remain well above the production levels that most analysts believe will be required even at the peak of the current economic recovery, and excess capacity probably will continue to burden the steel market throughout the 1980s.

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*IMF Financing
for El Salvador
in Peril*

A suspension of IMF lending to El Salvador over the remainder of this year appears increasingly likely. According to Central Bank President Benitez, the Salvadoran Government may be unwilling to effect IMF-prescribed austerity measures in return for the \$35 million offered under standby loan arrangements.

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With elections scheduled for late this year, however, we believe the IMF probably will balk at signing a new agreement with an outgoing government.

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National Developments

Developed Countries

South African Budget

The Government's FY 1983/84 budget, presented to Parliament last week by South African Finance Minister Horwood, projects a deficit of about \$2 billion and conforms almost exactly to the guideline of 2 percent of GDP established by the IMF as a condition for balance-of-payments assistance last year. Overall spending is set to rise by more than 11 percent—slightly less than the 12-percent rate of inflation projected by the government for this year—while revenues are to increase by nearly 10 percent.

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Keeping spending down to the budgeted level and controlling the deficit will be difficult. Severe drought probably will force Pretoria to import food, and it may become necessary to raise further the level of relief spending for farmers. Defense, which has received only a 7-percent increase, appears to be under-budgeted and—for the second year in a row—may require a supplemental

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appropriation to cover actual spending. Many prominent South African bankers believe that the government's revenue assumptions are overly optimistic, according to the US Embassy. Revenue will be reduced further when a 5-percent surcharge on imports is eliminated by the end of the year to satisfy an IMF condition. Although Horwood probably used a conservative estimate of the price of gold in his revenue projections, gold's volatility will be a key factor in determining the actual budget outcome.

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Less Developed Countries

Serious Shortage of Imported Goods in Mexico

Growing import shortages are further slashing private-sector production. New official trade data indicate that merchandise imports plunged 73 percent in January from year-earlier levels. Imports fell 56 percent during September through December 1982. We estimate that imports in February and March remained at least 60 percent below last year. Mexico's debt moratorium interrupted normal trade credit lines, limiting imports to goods that could be paid for by cash or barter.

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Mexican industrial and government officials predict, and we agree, that no rebound in imports will be possible soon, despite the \$5 billion commercial credit signed in March. The bulk of the initial \$1.7 billion installment is being used to repay a \$500 million bridge loan, catch up on public- and-private sector interest obligations, and partially rebuild depleted reserves. With no quick resolution of the debt moratorium or reversal of capital flight in sight, we believe imports will remain drastically reduced during the next six months at least.

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Because of shortages of critical imported raw materials, manufacturers have closed numerous factories, and many industries report current production off 50 to 65 percent.

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Many exporters have not been able to maintain production because of exchange losses suffered under Mexico's tight foreign exchange controls. As a result, bankruptcies are up sharply, unemployment is growing, local supplies of final goods are dwindling, and inflationary pressures are mounting.

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Iraq Seeking Financial Assistance

Iraq is negotiating new financial arrangements with France, West Germany, and Japan to help cover payments for arms purchases and civilian projects. Baghdad reportedly agreed last week to provide France \$530 million worth of crude oil annually to help finance about 60 percent of its \$5 billion arms debt. Iraq is seeking the necessary 50,000 barrels of oil per day from Qatar. In addition, the Iraqi Foreign Minister says Kuwait will finance at least \$100 million for the purchase from France of Super Estandard naval strike aircraft and Gazelle helicopters. West German companies have offered to defer for two

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years payments due in 1983 on an estimated \$1.2 billion that Iraq will owe for work on industrial projects, according to the US Interests Section in Baghdad. Last week the West German agency that insures export credits agreed to guarantee these payments. The Iraqis, however, have turned down a Japanese proposal that would enable them to defer only until 1984 payments due Japan.

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Iraq, meanwhile, finally has received a \$500 million commercial loan syndicated primarily by Arab banks. This syndication is in addition to the \$1,050 million in concessionary loans that Iraq has received thus far from the other Arab states of the Persian Gulf. Last year Baghdad received about \$5.5 billion from those states. Western governments and companies probably will continue to be at least partly responsive to Iraqi requests for concessions in hopes of salvaging their already heavy financial commitments and of gaining lucrative contracts in Iraq when the war ends. At the same time, the limited Western participation in the commercial loan does not augur well for new bank credits. Iraq is likely to count on the Persian Gulf states to provide additional financial aid. [redacted]

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Kuwait Drawing on Investment Income

The decline last year in Kuwait's oil revenues by almost 35 percent has created cash flow problems. Kuwait's investment income of some \$7 billion, however, now is about the same as its income from oil revenues and provides a cushion to cover revenue shortfalls. [redacted] the government is using an increasing share of investment income—normally reinvested in foreign assets—to cover current expenditures, such as salaries and subsidies. In addition, officials are shifting some of the \$70 billion in foreign assets to high-yield, short-term dollar investments from long-term investments—anticipating that the government will be forced to draw on them. Kuwait is probably in a better position to weather the current slack oil market than most Gulf states because of its small population, its small-scale domestic capital investment program, and its large buildup of foreign assets. [redacted]

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Cuban Crop Losses

Almost constant rain and high winds have resulted in serious crop losses for Cuba. A Western embassy in Havana places the loss of sugar at 1 million tons, or about \$150 million in hard currency at current market prices. Cuban press reports indicate that nearly 30 percent of the tobacco crop was destroyed for an additional loss of \$25 million. Sixty-five percent of the tomato crop and 25 percent of other basic foodstuffs also were destroyed, according to the Cuban press. Moreover, spring plantings have been interrupted and agricultural facilities have been damaged. [redacted]

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Although Havana may be exaggerating the extent of the damage to manipulate the international price of sugar or use weather losses as an excuse for not reaching its planned output for sugar, [redacted] 25X1 excessive rains have delayed the harvest. The heavy press coverage given to crop losses by Havana suggests that it will opt for increased consumer austerity rather than significantly increase its hard currency debt to accommodate food imports. Without additional Western credits, Havana may appeal to Western countries, particularly sympathetic ones such as Spain, for favorable financing terms for food imports and may request increased aid from the USSR. Moscow will be reluctant to provide much, if any, convertible currency assistance to Cuba but may permit Havana to decrease its protocol commitment of sugar exports to the Soviet Union, freeing these exports for hard currency markets in the West. A loss of revenue from lower sugar and tobacco exports would decrease Cuba's already slim chances for meeting trade targets established in its recent debt rescheduling agreement. [redacted]

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*Banana Crop Damage
in Honduras
and Guatemala*

Foreign exchange losses as a result of extensive wind damage last month to Honduras's banana crop could reach \$70 million, equal to a 10-percent cut in already depressed export projections for 1983. Guatemala stands to lose about \$50 million because of similar damage. The resulting reduction in export taxes could widen troublesome budget deficits in these countries. Moreover, the suspension of a total of 5,000 banana workers will aggravate unemployment in the banana-growing regions and could lead to labor unrest. Because the multinational fruit companies will be hard pressed to raise the \$15 million needed in each country to replace ruined banana trees, they may scale down their operations still more, further depressing economic activity. [redacted]

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*Possible Labor
Unrest in Zambia*

Zambia's powerful trade union confederation has threatened to call a nationwide strike this month if the government does not agree to negotiate with the unions on wage and price issues. Government officials have been unwilling to meet with labor leaders to discuss their demands for repeal of a wage ceiling and restoration of price controls on essential commodities. The wage restrictions and deregulation of prices were among a series of austerity measures imposed by President Kaunda in December and January to meet IMF conditions for a major loan, which is now being negotiated. Kaunda, who is mindful of severe labor unrest in 1981 and anxious for strong support from the unions in the national elections scheduled for November, probably will try to negotiate a compromise. Nonetheless, he may have difficulty coming up with a package that satisfies the unions without alienating the IMF. [redacted]

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*Trinidad and Tobago's
Oil Financing Facility
To End*

Trinidad and Tobago's oil facility, which Port-of-Spain had hoped would establish the oil- and gas-rich minestate as a leader among its Caribbean neighbors, probably will lapse soon because of falling oil revenues and inept administration of the program. Modeled after the Mexican and Venezuelan programs, Trinidad's version was to make concessional loans to its regional oil consumers. According to US Embassy reports, only \$78 million of the \$200 million promised in 1980 has been disbursed—\$75 million to Guyana and the rest to Barbados. The Guyanese regime is so widely despised in Trinidad that the full extent of disbursements has been hidden. Credits to Jamaica never materialized because Trinidad tried to wring routing concessions for its money-losing national airline out of Kingston. Other Caribbean ministates could not comply with the complicated documentation demanded, and additional help for Barbados fell victim to wrangling over technicalities. Approval of the \$50 million in pending applications is unlikely. Trinidadian officials will likely benefit politically at home by letting the program expire.

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*IMF Assistance for
Bangladesh*

According to Embassy reporting, the IMF has approved a new \$730,000 standby loan for Bangladesh. The disbursements are particularly timely, with earnings from jute exports depressed, foreign exchange reserves equivalent to less than one month of imports, and access to international credit limited. The IMF-mandated restrictions on credit and government spending, however, will moderate any economic recovery in 1983. Moreover, Chief Martial Law Administrator Ershad will be hard pressed to keep public spending within IMF guidelines.

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*Status of Soviet
Gas Pipeline
Construction*

This daily average of nearly 20 kilometers is roughly the same rate that Soviet press reports claim has been achieved since the beginning of the year. The Soviet media also report that a total of about 3,500 kilometers have been laid, leaving less than 1,000 kilometers to be completed this year, perhaps by as early as August.

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These claims probably are accurate, because winter is the peak construction season in Siberia and additional crews have been assigned to the project in recent months. Nevertheless, pipelaying is the least technically demanding part of the project, and much remains to be done in the construction of the compressor stations. The current plan to complete 17 of these this year appears ambitious. Even if these stations are not completed on time, however, the pipeline could be operated at less than full capacity, and initial gas deliveries could be made to Western Europe.

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*Improvements at Soviet
Grain Ports*

The USSR has begun a major program to install advanced grain-handling equipment. The Soviets have ordered 32 high-output, pneumatic unloading towers from West Germany at a cost of about \$120 million. Since early February, eight of these towers have been put into operation at three grain ports [redacted]. Each of the new towers can handle at least 300 tons of grain per hour, three to five times the output of most Soviet dockside equipment now in use. [redacted]

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The 12 towers will increase the rated capacity of all unloading equipment in major grain ports by 25 percent, or to at least 6.2 million tons per month. The 20 towers on order could increase capacity by almost 2 million additional tons per month. It is unclear, however, why the Soviets are acquiring so much new offloading equipment. Seasonal shortages of grain railcars have prevented full year-round use of existing port equipment for several years, and little storage capacity is being added at the ports to hold grain awaiting rail transportation.

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Brazil: Bleak Economic Prospects

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Brazil continues to face foreign exchange difficulties despite the conclusion of new loan agreements. The government is now making the adjustments required to retain crucial bank support but, with the austerity program already drawing fire, it probably will waver and fail to meet all IMF targets. At best, Brazil this year will experience a contraction of 3 to 5 percent in economic activity accompanied by a 95-percent rate of inflation, and growing political unrest.

The risk remains that Brasilia may yet declare a payments moratorium; indeed, the financial press is openly speculating that a payments suspension is imminent. Such an event would lead to a cessation of all new lending, causing economic activity to plummet at a 10-percent annual rate while driving inflation into triple digits. Under such conditions, Brazil's economic crisis would severely test the government's ability to cope with political stress, spill over to other South American borrowers, and adversely affect US bank and business interests.

The Government Responds

Since December, Planning Minister Delfim Netto has tried to engineer a major rescue operation. To regain banker support, he promised a variety of policy adjustments. A stabilization plan, endorsed by the IMF, calls for tough measures to slash the 1983 current account deficit 50 percent to \$7 billion and to reduce inflation to an annual rate of 70 percent by December.

According to Embassy and press reporting, Brasilia has moved to slow the economy and strengthen the external accounts. To reduce the public deficit, Brasilia ordered new cuts in Treasury spending, a 20-percent reduction in state corporation investment, tax increases, and hikes in public-sector

tariffs. The National Monetary Council tried to slow rapid monetary expansion by increasing agricultural interest rates, tightening eligibility standards for some subsidized credits, and ordering price hikes aimed at phasing out wheat and petroleum product subsidies. The government's economic team also announced a modification of wage policy, a large devaluation to stimulate exports and restrain imports, and cuts in overseas tourist allowances.

The economic retrenchments have provoked sharp criticism of government policies from opposition politicians, the media, and union leaders. The abrupt shifts in policy have drawn fire, especially in the new Congress. Embassy and press reporting also indicate that Brazilian businessmen have become increasingly critical of the government's economic strategy. Moreover, restrictions in the salary law and rising unemployment are causing frequent wildcat strikes.

Without violating its IMF agreement, Brasilia has taken steps to assuage its domestic critics and regain business confidence. In February the government reinstated price controls on 273 products in an effort to dampen inflation. On 4 March the government announced three new programs to help small businesses obtain additional financing and promote exports. Later in the month, the National Monetary Council announced a series of measures aimed at lowering domestic interest rates and ending speculation in the financial markets. Additionally, Brasilia has attempted to offset some of the adverse impact of the February devaluation by instructing banks to make available new credits at preferential rates to firms with dollar-denominated debts and lowering import taxes on purchases of mineral, metal, and chemical products.

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Brazil's Financial Package

Following the extension of the \$1.2 billion loan from the United States in December, Brasilia still found it had serious financial problems. This made it imperative to obtain IMF financial assistance and commercial bank lending support.

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The IMF

The IMF will provide Brazil with \$5.9 billion in financial assistance through 1985 in return for its pledge to make economic adjustments. This includes \$4.8 billion under a three-year Extended Fund Facility, and \$1.1 billion from the Compensatory Financing Facility. Brazil withdrew \$500 million from the CFF in December and plans to take \$2.5 billion from both facilities this year.

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The Private Banks

Support from the IMF was contingent upon assistance from private banks. On 20 December 1982 Brasilia petitioned its leading creditors for a four-part financial package including:

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- A \$4.4 billion medium-term loan, which would increase bank exposure in Brazil by 7 percent.

- Rollover of principal payments owed to commercial banks maturing this year. The rollover would be made directly to Brazil's Central Bank for eight years and contains a two-and-one-half-year grace period.
- Continued access to \$8.8 billion in short-term trade related credits—mostly for raw material imports and export prefinancing.
- Restoration of \$5 billion in interbank credit lines with Brazilian bank branches abroad.

Brazil completed the first two parts of the financing program in February. Bankers have committed an estimated \$10 billion in short-term trade financing facilities

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Brasilia has a long and treacherous path yet to travel. The last few months have seen inflation spurt to an annual rate of 105 percent in February, and the \$330 million trade surplus through February was nearly 70 percent short of the level needed to meet the IMF target. According to Embassy reporting, the economic team has begun to lose credibility, and no near-term successes are in sight. The large devaluation in late February will push inflation higher in March while doing little to strengthen the trade accounts.

mid-March, Brasilia is already encountering renewed foreign exchange difficulties.

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Until bankers resume short-term lending and exports strengthen, Brazil probably will have difficulty covering its daily cash position. Unless bankers reactivate standby credits, either Brazil's arrearages will continue to increase in the face of roughly \$2 billion in monthly import and interest payments or sorely needed goods will stop flowing in and the recession will worsen sharply.

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The Eye of the Storm

Over the next several months we anticipate a resurgence of external financial difficulties. Even with the disbursements of most of the new loans in

Failure to stop capital flight will add to persistent cash-flow difficulties.

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[redacted] growing doubts about Brazil's economic prospects caused businessmen to channel funds into overseas money market accounts this year. Renewed speculation about another large devaluation will provide new incentives to get funds out of the country.

Despite the large devaluations, we anticipate lack-luster export performance until at least late summer. Although Brazil may reach its \$22 billion export target for 1983, exports will be stalled for a while by weak recovery in consumer and industrial demand in the developed countries, weak commodity prices, and tougher import restrictions in Brazil's major Third World markets. Beyond this, a continuation of exports outside of official channels could also hinder the government's ability to achieve its goals.

We judge that Brasilia's economic team will also have problems in complying with the IMF's domestic performance targets.¹ The failure to increase interest rates for export credits, the lack of a precise timetable for phasing out product subsidies, and the application of only a moderate increase in agricultural interest rates is already translating into stronger-than-anticipated demand for funds. According to Embassy reporting, monetary expansion surged to a 97-percent annual rate in February compared with 85 percent for 1982. Beyond this, the large devaluation and the failure to apply tough wage restraints will continue to fuel inflation. Based on Embassy reports, we doubt that Brasilia will meet its public-sector financing targets. The

¹ Some problems have already arisen. On 5 March, Brasilia amended the original IMF agreement. Because of the large devaluation, the government revised its inflation target to 85 to 90 percent in December. It also respecified quarterly balance-of-payments performance requirements but did not modify the annual external targets.

initial expenditure cuts and revenue measures probably will prove inadequate to offset automatic spending increases triggered by rising inflation.

These problems augur renewed tensions in dealing with the international banking community. With arrearages again building, Central Bank President Langoni has renewed appeals to creditors—without success thus far—to provide new standby credits to meet immediate obligations. We and a number of banking sources expect Brasilia will seek \$2-4 billion in new loans before the end of September. Any such request for funds probably will be greeted by demands for even tougher austerity measures.

Even as difficult new adjustments are required, we believe Brasilia will encounter intensifying domestic criticism of its stabilization program. Based on past experience, state corporations, agricultural producers, and businessmen probably will bid for concessions to blunt the impact of austerity. As consumer prices and unemployment rise, opposition will broaden to include the middle class and labor. The increased assertiveness of the Congress and state governors that has grown out of recent political liberalization will complicate efforts to carry out the austerity program. At this juncture, we believe the government is likely to hold the line on the measures already enacted but waver on implementing unpopular new measures that could spark political problems.

The Economy in 1983

We believe the only plausible scenarios for Brazilian economic performance entail declines in real output this year. The severity of the decline will depend on the willingness of Brazil's foreign creditors to provide additional financial support. We

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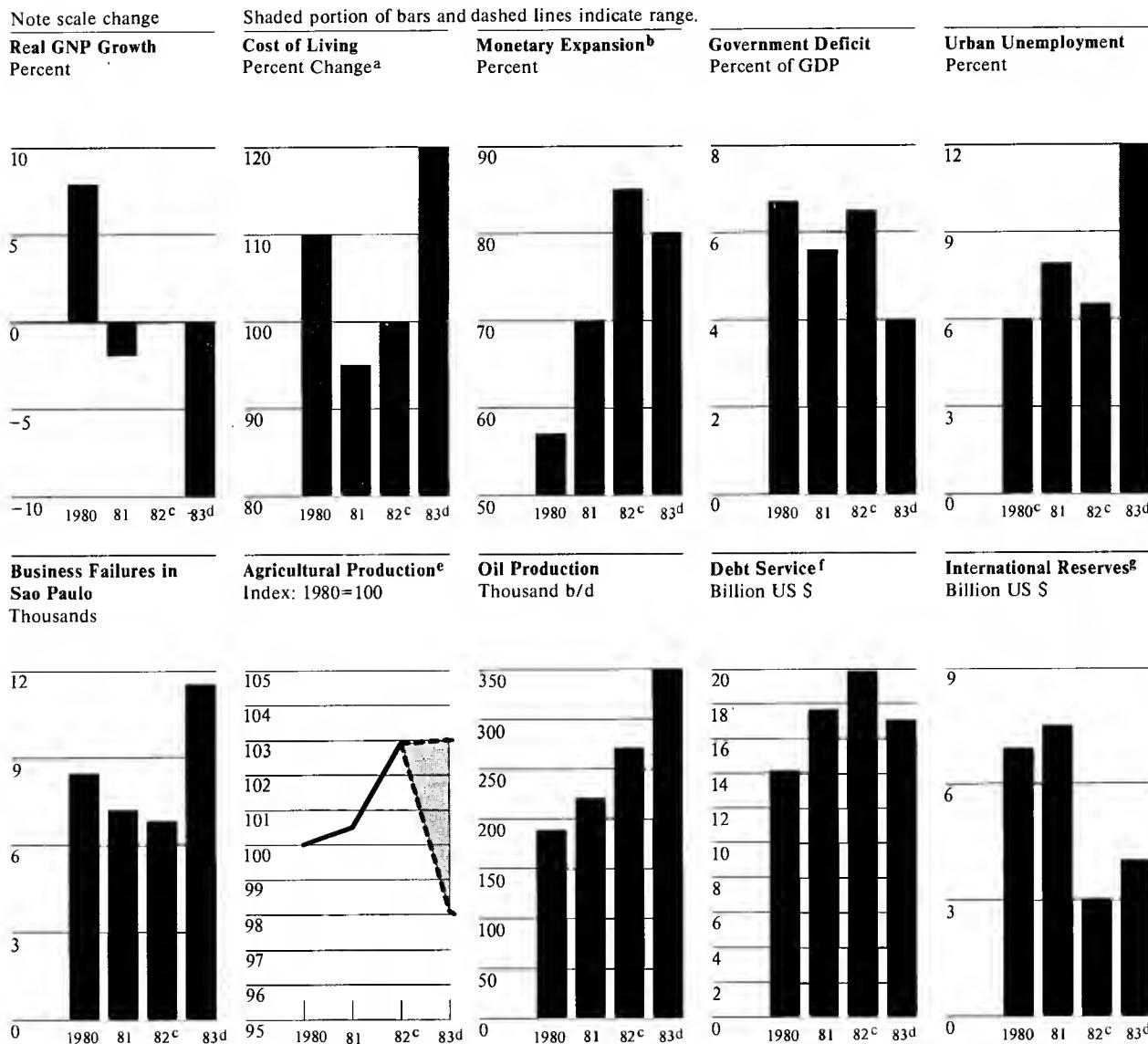
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Brazil: Economic Indicators^a December to December.^b Change in the money base.^c Estimated.^d Range estimates, best case assumes Brazil is able to finance an \$8 billion current account deficit; worse case assumes Brazil declares a payments moratorium.^e Production of beans, corn, manioc, rice, soybeans, and wheat.^f Interest payments and long-term principal repayments.^g Mainly illiquid in 1982 and 1983.

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Secret**Brazil: Balance of Payments****Billion US \$**

	1980	1981	1982 ^a	1983 ^a	
				Case A ^b	Case B ^c
Current account balance	-12.4	-11.0	-14.5	-8.0	5.5
Trade balance (f.o.b.)	-2.8	1.2	0.8	4.5	7.0
Exports	20.1	23.3	20.2	21.5	20.0
Imports	22.9	22.1	19.4	17.0	13.0
Service balance, net	-9.6	-12.2	-15.3	-12.5	-12.5
Interest payments	7.4	10.3	12.0	9.7	9.7
Debt repayments	12.7	16.3	20.8	20.2	20.2
Longer term maturities	6.7	7.3	7.8	7.2	7.2
Short-term maturities	6.0	9.0	13.0	13.0	13.0
Gross foreign exchange requirements	25.1	27.3	35.3	28.2	25.7
Financed by:					
Direct investment, net	1.1	1.6	1.1	1.0	1.0
Official and supplier credits	4.2	3.4	5.2	4.0	3.5
Loans	18.4	24.2	27.0	24.7	22.7
Bridge operations			4.0	-3.0 ^d	-3.0 ^d
Short-term rollovers	6.0	9.0	10.0	13.0	13.0
Short-term borrowings	3.5	1.5	0.5	0.5	1.5
Long-term credits	8.9	13.7	12.5	14.2 ^e	11.2 ^e
Other	1.4	-1.9	2.0	-1.5	-1.5

^a Estimate.^d Central Bank of Brazil estimate.^b Assumes Brazil obtains bank support.^c Includes \$2.5 billion from IMF.^c Assumes Brazil declares a moratorium in the summer of 1983.

have analyzed the domestic and international results for the Brazilian economy—drawing upon our own work and that of econometric services and independent analysts—under the assumption that international bankers accommodate a request for some additional financial support. In the worst case, we have tried to assess the consequences for Brazil if its foreign funding dries up later this year.

The Likely Course. Although world economic recovery and lower oil prices probably will lead to a \$4-5 billion trade surplus for Brazil in 1983, this will still fall short of the \$6 billion IMF target. Even with the fall in world interest rates, the

government probably will reduce its current account deficit only to some \$8 billion this year. As the trade shortfall becomes apparent, the Brazilians probably will have to ask creditors for another loan.

Based on recent conversations, we believe bankers will accommodate Brazil if the government is perceived to be making a good-faith adjustment. The bankers appear willing to extend some additional financial support as long as Brasilia sustains its stabilization program, its efforts to increase exports, and its willingness to service the debt. Even so, we foresee temporary funding gaps.

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Belt tightening and foreign financing constraints will cause national output to fall by 3 to 5 percent. The economic contraction—borne by industry and domestic commerce—will be accompanied by growing unemployment and business failures. Despite wage restraints and price controls, the December over December inflation rate will approach triple digits because of the large devaluation, increases in public utility rates, and import restrictions.

Another year of worsening economic performance will heighten social unrest. Economic deprivation following retrenchment and persistent triple-digit inflation probably will increase violent crime, wildcat strikes, and cost-of-living demonstrations. Because of its firm monopoly on the instruments of force, we believe the Figueiredo government will be able to avoid serious problems. Moreover, the government probably will appeal to Brazilian willingness to make sacrifices for *grandeza*, major power status.

A Worst Case Scenario. If the government misses its stabilization targets by a wide margin, however, bankers probably will refuse new credit requests. With its reserves depleted, Brasilia would have little choice but to declare a temporary moratorium on debt payments. Such a declaration would cause a cessation of all foreign lending until new austerity and rescheduling arrangements are worked out. With its borrowings cut, we believe Brasilia would be forced to reduce the current account deficit to \$5.5 billion, mainly by slashing imports.

The economy probably would go into a severe tailspin. The reduced availability of critical raw material imports—metals, oil, chemicals—would cause severe disruptions in industrial production. We estimate that real growth would fall at a 10-percent annual rate as the industrial downturn reduced new investments and caused declines in construction and commercial activities. A severe cash-flow squeeze probably would result in a wave of business failures, sending unemployment into double digits. In these circumstances, commodity shortages would boost inflation above 100 percent.

Such an economic crisis would severely test the government's ability to cope with political stress. At this juncture, however, we cannot judge the likely consequences.

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Signs To Watch

New external shocks could quickly gut Brasilia's stabilization program. With the debt service ratio hovering at the 80-percent level, any export shortfalls induced by climatic disaster, low commodity prices, or continued recession in industrial nations would pose unmanageable financial strains. Brazil also remains vulnerable to higher world interest rates; a 1-percentage-point increase in LIBOR would add an estimated \$500-600 million annually to debt servicing obligations. Beyond this, Brasilia may yet be forced to declare a payments moratorium if its major creditors split over the country's financial strategy and thereby prevent the syndication of a large new credit.

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Failure to regain public confidence could also have serious economic consequences. Speculation in the financial markets would intensify, preventing any increase in domestic capital formation. Businessmen probably would continue to postpone most new investment programs at home and persist in capital flight.

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Implications for the United States

We believe Brazil will increasingly look to the United States for support in resolving its financial problems. Until private bankers reconstitute the safety net arrangement, Brasilia probably will call on Washington from time to time for emergency financial support. Based on Embassy reporting, we also expect the Brazilian Government to press Washington to lead the effort to reschedule official credits maturing in 1983. As the need for new money becomes apparent, Brasilia may expect the United States to back credits to finance imports and assistance in discounting trade receivables with US banks.

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Any disruption in debt servicing could spur Brasilia to seek debt relief. A formal debt rescheduling would be forced to consider stretching principal and interest payments to lessen Brazil's foreign exchange stringencies. Interest payments are now the single-largest outflow in the current account, claiming 45 percent of export earnings. If, in the worst case, bankers were unwilling to cooperate, a prolonged interest moratorium would further reduce US bank profits and could cause some severe problems. Moreover, Brazil's troubles would adversely affect other South American borrowers, further intensifying the adverse impact on the US economy as they make even tougher import cuts and suspend repayments. [redacted]

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A payments moratorium remains a continuing possibility. Much of the immediate impact of a moratorium would fall on the nine largest US commercial banks' profit positions. Brasilia would also face the need to make larger-than-anticipated import cuts, thereby reducing even further US exports to that market. [redacted]

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Venezuela: Worsening Economic Outlook

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Venezuela's economic problems reflect in part its extreme dependence on oil exports and bankers' reluctance to lend in Latin America. Its basic problems, however, are the government's overspending of the oil bonanza, its failure to diversify the economy, and its poor management of foreign debt. For 1983, Caracas's ability to pursue effective adjustment policies will be hampered by mounting political pressures spawned by the upcoming December presidential elections.

The government's unwillingness to adopt a strict adjustment program has left international bankers reluctant to cooperate in refinancing Caracas's large external debt. Indeed, [redacted] the Venezuelan Government has yet to realize the seriousness of its financial position. To regain banker support, we believe that Venezuela will ultimately resort to the IMF this year. The imposition of a tough IMF stabilization program will contribute to further economic decline in the near term.

The Seeds of the Present Crisis

Venezuela's current financial stress emerged over a year ago as oil revenues dropped abruptly. In 1982 oil export revenues fell by 20 percent. Dependent on oil for 70 percent of all budget revenues, Caracas was forced to trim planned central government expenditures for 1982 by over \$4 billion and introduce new revenue measures, including a sharp increase in gasoline prices. The government was able to avoid even tougher spending cuts—particularly for politically sacrosanct social programs—by [redacted]

boosting oil production from 1.5 million b/d in second-quarter 1982 to 2.3 million b/d by the end of the year.

The decline in oil revenues contributed to a loss of foreign lender confidence. Wary bankers began insisting on sharply higher rates for new borrowings. Caracas refused to accede to banker demands, awaiting a rebound in its oil prospects and creditworthiness. It postponed plans to restructure into longer maturities some \$8.8 billion in maturing short-term debt. This move backfired, however, in the wake of Argentine and Mexican repayment problems. In September, Caracas was stunned by demands to pay off large loans for two cash-strapped government agencies suddenly unable to roll over debt. A subsequent restructuring attempt attracted only half the targeted amounts even though Caracas accepted tougher borrowing terms and offered to guarantee the debt of less credit-worthy state corporations. Looming financial problems undermined domestic business confidence and promoted large-scale capital flight, which, according to Central Bank estimates, totaled \$5 billion for the year.

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The decline in oil revenues and consequent spending slowdown caused GNP to contract by 2 percent in 1982, according to US Embassy estimates. On the external front, the current account deteriorated by some \$6 billion; Venezuela registered a \$2.2 billion deficit on this account as exports dropped 20 percent. Moreover, the combined effect of loan payoffs and capital flight caused international reserves to drop by over 50 percent to \$8.5 billion, excluding a \$3 billion boost from a gold revaluation. The dropoff in economic activity and a meager 1.2-percent increase in the money supply reduced inflation to an 8-percent annual rate.

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Venezuela: Current Account*Billion US \$*

	1979	1980	1981	1982 ^a	1983 ^a	
			Best Case		Worst Case	
Trade balance	4.4	8.3	8.0	2.6	2.8	5.0
Merchandise exports, f.o.b.	14.4	19.0	20.1	16.0	14.1	12.5
Oil	13.7	18.3	19.1	15.5	13.3	11.7
Other	0.7	0.7	1.0	0.5	0.8	0.8
Merchandise imports, f.o.b.	10.0	10.7	12.1	13.4	11.3	7.5
Net services and transfers	-4.0	-4.7	-4.1	-4.8	-5.0	-5.0
Current account balance	0.4	3.6	3.9	-2.2	-2.2	0

^a Estimated.**Venezuela's Oil Earnings**

	1979	1980	1981	1982 ^a	1983 ^a	
			Best Case		Worst Case	
Oil export revenues (billion US \$)	13.7	18.3	19.1	15.5	13.3	11.7
Average production (million barrels/day)	2.36	2.16	2.11	1.89	1.75	2.3
Average exports (million barrels/day)	2.12	1.86	1.76	1.55	1.40	1.97
Average price per barrel of export crude (US \$)	17.70	26.95	29.70	27.40	26.00	16.22
Fiscal petroleum revenues (billion US \$)	7.7	10.6	16.5	11.7	8.7	7.2

^a Estimated.**Mounting Pressures for Retrenchment**

Anticipating little immediate improvement in the world oil market, Venezuelan President Herrera had planned to continue austere economic policies this year, his last in office. The 1983 budget originally called for a 10-percent cut in spending to \$18.1 billion, petroleum tax revenues of \$11.1 billion, and a zero deficit. For the second year in a row, nonoil investment programs bore the brunt of the cutbacks. With the latest OPEC accord, however, Venezuelan oil exports probably will be limited to only 1.4 million b/d instead of 1.6 million b/d, while Caracas will also receive at least \$1.50 less per barrel. This would cause projected oil tax revenues to decline 25 percent to \$8.7 billion. To balance this shortfall, even tougher budget and import cuts will be required.

Continuing reserve losses, demands for payments of maturing short-term debt, and disarray in oil markets are causing Caracas to take stronger measures to bolster its external payments position. In late February, the government suspended foreign exchange transactions for one week, implemented exchange controls, and introduced a three-tiered

multiple exchange rate—the first in 18 years. At the same time, prices on all goods and services were frozen for 60 days to prevent offsetting price increases in the wake of the implicit devaluation.

An additional source of pressure on the government comes from international banks who want stricter austerity measures before committing any funds. At a minimum, the current bank advisory group is demanding the formation of an intergovernmental team to devise a coordinated response to the present crisis.

Resorting to the IMF

We are skeptical that Caracas will be able to initiate an effective stabilization program on its own. With the President's Social Christian Party trailing in the presidential campaign that is now under way, Herrera continues to resist needed adjustment measures. He probably will remain

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extremely reluctant to implement measures that would raise unemployment and inflation in the short run. Moreover, intense squabbling over economic policies between the President's two main economic advisers, Finance Minister Sosa and Central Bank President Diaz Bruzual, has prevented effective implementation of some policies already adopted.

The government's poor management abilities have been alarmingly evident recently. Caracas has demonstrated itself incapable of administering the complex exchange system that it has been slowly defining over the past few weeks. Powerful interest groups have been lobbying for access to preferential exchange rates, potentially undermining the effectiveness of the system. Meanwhile, in recent meetings with bankers, Sosa had been unable to detail the actual amount of debt Venezuela wished to refinance or to present a realistic economic and financial outlook.

In a recent domestic press conference, Finance Minister Sosa indicated that Venezuela would resort to the IMF if debt refinancing bogs down and exchange controls are ineffective in stemming foreign reserve losses. We believe Caracas will soon have little choice but to begin formal debt rescheduling negotiations in conjunction with the IMF. According to the US Embassy, a formal standby arrangement with the IMF could enable Venezuela to obtain a maximum of \$4.5 billion over three years.

Tough adjustments will be required if Venezuela is to reach an agreement with the IMF. Press reports indicate that an IMF technical mission that recently paid a visit to Caracas proposed: (a) cuts of 20 percent or more in public spending, (b) the restructuring or liquidation of state-owned enterprises, (c) the removal of price controls and the withdrawal of consumer subsidies, (d) reductions in the public-sector wage bill, (e) continued tight monetary policy, and (f) a sharp devaluation.

Venezuela's Downward Financial Spiral

The initial debt restructuring plan formulated by Caracas last fall fell apart early this year. In January international lenders suspended refinancings of maturing credits because of mounting arrearages on debt repayments and fears of a precipitous drop in Venezuela's oil earnings. Consequently, public entities began informing their creditors that only interest would be paid pending the conclusion of government rescheduling efforts. An international advisory committee was set up in early March to respond to Finance Minister Sosa's request to stretch debt repayments through 1990 or beyond and grant a one- to two-year grace period. With bankers unwilling to move forward on Sosa's request, Caracas announced on 22 March that the suspension of principal payments for most public debt was formally extended to 1 July to give the government sufficient time to reschedule the entire \$13 billion in principal due this year. More recently, press reports indicate that bankers considered the stabilization plan Sosa detailed to them early this month inadequate because it failed to incorporate many of the tough recommendations proposed by the IMF technical team that just left Caracas.

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The Economy in 1983

For much of the remainder of this year, we expect Venezuela to be laboring under an IMF austerity program. Caracas will be forced to struggle with several budget-balancing tactics at the urging of its foreign creditors. These would include increased taxation of nonoil revenues, greater efforts to promote government efficiency, selected cuts in both investment projects and social services, and reduced subsidies for some consumer products.

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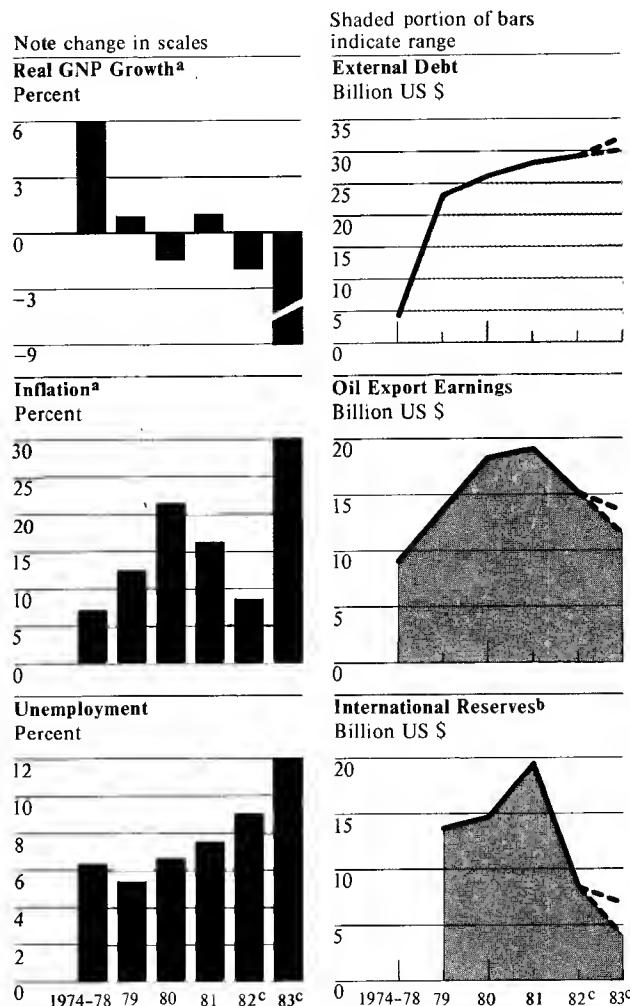
Baseline Scenario

While this adjustment program probably will be successful in regaining banker cooperation for the refinancing program, it will contribute to a further decline in economic performance this year. We expect GNP to decline at least 3 percent in 1983 and official unemployment to rise to 10 percent. This forecast assumes a decline of 15 percent in the oil sector and a 1-percent decline in the nonoil sectors. We believe that inflation would rise to 20 percent due to a sharp increase in the bolivar cost of imports and the elimination of some price controls. Despite a 15-percent drop in imports, we estimate that Venezuela will have to finance another \$2 billion of the current account deficit. Although debt rescheduling will be messy, Caracas probably will be able to restructure maturing debts and lift the payments suspension before the end of the year.

Worst Case Scenario

In the event that Caracas fails to adopt a coherent adjustment strategy or an OPEC oil price war erupts, the resultant financial crisis would cause a much sharper decline in the economy. Foreign exchange shortfalls would cause a scarcity of key imports, leading to shortages of consumer goods and food (over half of which is imported), and would create serious industrial bottlenecks. GNP probably would decline up to 9 percent, while inflation would surge to 30 percent. To bring the current account into balance, imports would have to be slashed more than 40 percent, probably through a large devaluation.

Such an upheaval would place unaccustomed strains on the political system. The strict austerity moves that would be required probably would provoke increased demonstrations and strikes by labor. We believe that serious unrest would be kept under control by expectations that labor would be given a significant role in fashioning economic policy under the likely new administration of the Democratic Action Party, to which it is closely allied. We think military intervention is unlikely.

Venezuela: Economic Indicators^a Average annual.^b Excludes reevaluation of gold holdings.^c Estimated.

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Signs To Watch

The current oil and liquidity crises are highlighting the failure to diversify the economy, which has left Venezuela's economic fortunes closely tied to trends in the world oil market. The adoption of needed reforms, as urged by international creditors, is now being echoed by officials of both major parties. We expect some restructuring of unprofitable state corporations to free resources for more productive uses. We also anticipate the cutting back of the swollen bureaucracy of 1.2 million people to improve government services and efficiency. As depressed oil revenues cause public expenditures to drop off, officials of both major parties, as well as international lenders, are citing the need to spur private-sector performance. New initiatives are being aired to permit market forces freer rein. This changing attitude also may lead to greater interest in attracting more foreign investment, which could eventually help correct the country's existing shortages of capital, technology, and skilled management.

We are concerned, however, about the impact of austerity on the highly profitable and efficient oil industry. Depressed profits and declining reserves already have caused the state-owned oil company, PDVSA, to scale back by roughly one-third the \$37 billion initially planned for investment during 1983-88 and to reconsider its overall development strategies. Oil Ministry officials now say they will concentrate on increasing production of light and medium crudes from traditional fields rather than accelerate production from the more costly Orinoco Heavy Oil Belt.

Implications for the United States

The United States has much at stake in Venezuela:

- Venezuela is our largest trading partner in South America and has traditionally relied on the United States for half of its imports.
- Venezuela remains our third-largest supplier of petroleum.

- US banks hold at least one-third of Venezuela's total estimated foreign debt of approximately \$32 billion, and US businesses have sizable direct investments there.
- Venezuela also remains a strong moral and financial supporter of democracy in Latin America.

We believe Venezuelan officials will continue seeking US help in coping with their financial dilemma.

[REDACTED]

These include the opening of an emergency line of credit to the US Treasury, the extension of credit for Venezuela's wheat imports, prepayment for future petroleum deliveries, and a gold swap arrangement. The Venezuelans have confirmed that they are especially seeking the cooperation of US banks in their debt refinancing efforts.

Declining resources may jeopardize the joint Venezuelan/Mexican oil financing facility. Since 1974 over \$6.5 billion has been disbursed in various forms of economic assistance to the Caribbean Basin. Although \$400 million was paid out in 1982, Venezuela has recently been discouraging the expectations of some recipients that it will either increase aid or soften credit terms. According to a US Embassy source, several administration officials have said that prospects are not encouraging for renewing the facility for another year when it expires in August. The source implied that if Mexico withdraws and the agreement lapses Venezuela probably will continue providing some reduced level of aid and look to the United States to step up its assistance. Meanwhile, the prospect of increasing Mexican-Venezuelan competition for the US oil market will, we believe, complicate Washington's relations with both countries.

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Secret**Spain: Socialist Economic Policy** [redacted]

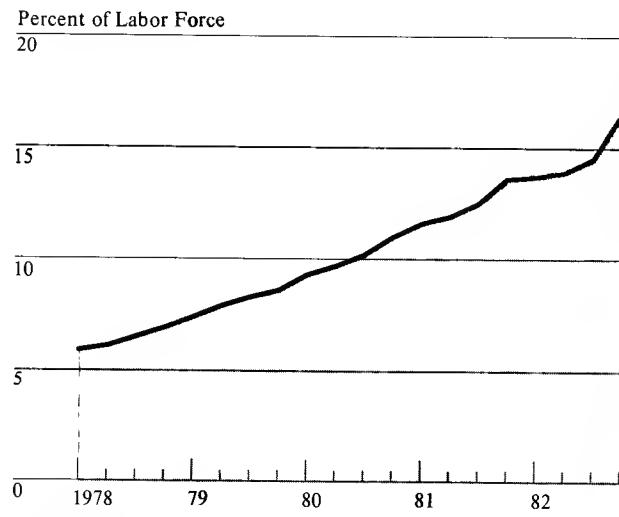
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The Socialist government has proposed a conservative economic program for 1983 that will do little to promote economic recovery. In the election campaign last fall the Socialists promised to boost real economic growth this year to 2.5 percent and to create 800,000 new jobs over the next four years. Now, however, their primary objectives appear to be reducing the inflation rate and the trade deficit. Consequently, monetary and fiscal policies will be tightened; these policies are unlikely to alleviate Spain's growing unemployment problem. According to Finance and Economic Minister Miguel Boyer, the government has no other option because expansionary policies would lead to renewed inflation and even larger payments deficits. [redacted]

The Protracted Slump

According to preliminary estimates, the Spanish economy stagnated in 1982 for the fourth consecutive year. Real GDP growth was approximately 1.1 percent compared with -0.3 percent in 1981; the increase derived almost entirely from the growth of public consumption and exports. Agricultural production improved from the drought-affected levels in 1981/82, but industrial production was held back by continuing problems of overcapacity, overmanning, low investment, and slack demand. The tourist industry was one of the brighter spots; the number of visitors during January- November 1982 was up about 5 percent from the previous year, while gross tourist revenues increased approximately 23 percent in pesetas and about 6 percent in dollar terms. [redacted]

Economic stagnation has produced an unemployment rate second only to Turkey in Western Europe. Registered unemployment rose by 400,000 during 1982 reaching 2.2 million, 16.5 percent of the labor force, by the end of the year. The number

Spain: Registered Unemployment^a^aQuarterly data.[redacted]
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of jobless rose most sharply in the industrial and service sectors, which employ about two-thirds of the labor force. Increased spending on public works prevented an even further increase in unemployment. [redacted]

Inflation has slowed for five consecutive years but, according to provisional statistics, was still 14.4 percent in 1982. While real wages rose by 2 to 5 percent each year during 1978-81, they fell last year by about 1 percent. The reduction in real wages resulted from the 1982 National Employment Agreement—a pact involving government,

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Spain: Balance of Payments*Million US \$*

	1978	1979	1980	1981	1982 a
Current account balance	1,633	1,126	-4,988	-4,977	-4,058
Trade balance	-4,024	-5,671	-11,461	-10,115	-9,238
Exports, f.o.b.	13,480	18,352	20,928	20,450	19,918
Imports, f.o.b.	17,505	24,022	32,389	30,565	29,156
Invisibles balance	5,657	6,796	6,472	5,138	5,180
Tourism	4,917	5,558	5,720	5,708	6,050
Long-term capital (net)	1,718	3,216	4,194	4,254	1,250
Private	2,113	2,835	4,020	3,413	215
Official	-395	382	174	841	1,035
Short-term capital, including errors, omissions, and other monetary movements	538	-1,357	-548	-58	-678
Change in reserves	3,889	2,985	-1,342	-781	-3,486

a Preliminary.

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business, and labor aimed at preventing further increases in unemployment in return for wage moderation. Labor unions will have to make even greater concessions, however, to achieve Madrid's goal of pushing inflation rates closer to those in other industrial nations. Spanish inflation has exceeded the average rate in the OECD by at least 3 percentage points in each of the last five years, and last year the differential widened to nearly 7 percentage points.

Despite high inflation and world recession, the current account deficit narrowed by \$900 million to \$4.1 billion in 1982. Export volume increased by 2.5 percent over 1981, even though the growing differential between inflation rates in Spain and the rest of the OECD reduced export competitiveness. The dollar value of exports shrank by half a billion dollars suggesting that exporters accepted lower profit margins in return for a larger share of the market. Imports are estimated to have fallen \$1.4 billion over the previous year, reflecting lower

energy imports. Consequently, the trade deficit narrowed by approximately \$900 million to \$9.2 billion.

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To finance its 1982 balance-of-payments deficit, Madrid was forced to draw down its reserves by \$3.5 billion. Private long-term capital inflows traditionally have been large, ranging from \$2 billion to \$4 billion annually in 1978-81. Last year, however, negative interest differentials, the continuing depreciation of the peseta, and the introduction of peseta-denominated syndications by foreign bank branches prompted a shift in corporate borrowing from the Eurocurrency market to the domestic market. Firms were discouraged from seeking new loans abroad by the prospect of rising interest payments; in addition, many outstanding foreign debts were prepaid and replaced with domestic credits. As a result, net private external borrowing

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dropped from \$2.5 billion to \$650 million. Moreover, increased trade financing contributed to the expansion of net private external lending from \$627 million to \$1.4 billion.

3 percent, a sharp drop from the 15- to 20-percent increases in the 1981 and 1982 budgets. In addition, taxes on larger incomes will be increased, and the proportion of taxes to GDP will be raised from 13.4 percent to 14.5 percent.

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Socialist Policy Response

Despite the severity of Spain's unemployment problem, the Socialist program emphasizes controlling inflation and improving the balance of payments. Consistent with these objectives, the government plans to tighten monetary policy this year by holding money growth to 13 percent, compared with about 16 percent in both 1981 and 1982. In addition, Madrid has cut about \$1 billion from the banks' lendable reserves by increasing the amount of cash reserves private banks must hold from 5.75 percent to 6.75 percent of non-interest-earning deposits. The government may tighten credit further by increasing the reserve requirement on selected interest-earning deposits.

The government's preoccupation with the trade imbalance probably was a factor in the decision to stop supporting the peseta in December 1982. During the first 11 months of 1982 the peseta had depreciated by 18 percent against the dollar, and on 4 December Madrid announced a further 8-percent devaluation. Although critics charged that a devaluation of 25 to 30 percent was needed to stimulate export growth, Boyer argued that a larger devaluation would have caused excessive increases in import costs. Since December 1982 the peseta has depreciated another 7 percent. Nevertheless, the Bank of Spain is not planning a second devaluation. Instead, it intends to manage the peseta's downward float.

The 1983 budget has not yet been presented to Parliament, but it is expected to call for a \$12 billion deficit; the 1982 deficit of \$10 billion equaled 6 percent of GDP. Public statements by government officials suggest that greater social security and unemployment benefits will be responsible for most of the increase. Growth in real public-sector investment will be limited to about

During the election campaign the Socialists promised to create 200,000 new jobs each year for the next four years. They envisioned that this would take care of the 140,000 new entrants into the job market each year and reduce the number of unemployed by 60,000 annually. The plans advanced to date have been rather modest and have not entailed any government expenditure. The administration has sent a bill to Parliament proposing a reduction of the workweek from 44 hours to 40 hours and the establishment of a minimum 30-day vacation. According to Joaquin Almunia, the Minister of Labor, the measure was intended to prevent job losses in the near term. When the economy recovers, the Socialists hope that firms will hire more workers. The administration has also lowered the permitted ratio of temporary workers to permanent employees and reduced the duration of temporary contracts in the hope of forcing employers to create permanent jobs.

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Outlook

The Socialists probably will be unable to achieve all their economic objectives. Their conservative policies, coupled with a weak recovery at best among other West European countries, suggest that their revised goal of attaining 2-percent real growth in GDP is too optimistic. Because of depressed demand in the developed countries, it is highly likely that real export growth will fall well short of the impressive 12-percent average rate of growth over the last 10 years. High interest rates and high unemployment probably will continue to depress private investment and consumption. Most of the impetus for economic growth thus will have to come from the public sector. The Socialists, however, intend to increase expenditures only moderately in order to prevent sharp increases in the budget deficit and additional inflationary pressure.

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Madrid's monetary targets are shaky. Money stock growth could exceed the planned 13 percent if—as is likely—the budget deficit is financed through money creation to the same degree as in the last two years. In 1981 and 1982, borrowing from the Bank of Spain covered nearly three-fourths of the government's total financing requirement. The central bank attempted to offset the inflationary impact of this approach by limiting the amount of credit available to the private sector. If the Socialists monetize a similar proportion of the deficit through central bank borrowings in 1983, they will either have to impose even greater credit restrictions, which could dampen private investment, or raise their liquidity target.

The government's ability to meet its targeted inflation rate of 12 percent will depend on its monetary policy and on its success in promoting wage moderation. Another round of real wage reductions is needed to lower inflation to 12 percent. A collective bargaining agreement was signed in January between the employers' association, the General Workers' Union, and the Confederation of Workers' Commissions, which set the range for 1983 salary increases at 9.5 to 12.5 percent. Although the initial wage increases could on average be somewhat lower than the government's target, the agreement stipulates that if the consumer price index rises by more than 9 percent by 30 September 1983, wages will be revised in order to maintain the workers' real purchasing power.

Government increases in administered prices, such as fuel, electricity, and public transportation, will make achievement of Madrid's inflation and wage goals difficult. Shortly after taking office, the Socialists announced price hikes of approximately 20 percent for petroleum products. Government officials estimate that these increases will add 1.5 to 2 percentage points to the inflation rate next year. A proposed 7-percent increase in electricity rates and boosts in coal and natural gas prices of 10 and 17 percent, respectively, will further aggravate inflation.

Registered unemployment probably will continue to grow and may approach 20 percent by the end of 1983. A study completed by the National Institute of Employment estimates that in order to prevent further increases in unemployment, real GDP would have to grow by at least 3.5 percent this year; we believe that Spanish growth will only be about 1 percent in 1983. Moreover, the labor proposals advanced by the Socialists may have a detrimental effect on the job market. For example, the Spanish Confederation of Business Organizations contends that a shorter workweek would increase employers' costs and reduce productivity without providing incentives to hire more workers. The confederation also argues that increases in employers' contributions to social security make labor more expensive. Moreover, government plans to rationalize the textile, footwear, shipbuilding, and steel industries will cut the work force in these industries as much as 20 percent.

As the ranks of the unemployed grow, Prime Minister Felipe Gonzalez probably will face mounting pressure to change the direction of economic policy. The Socialists currently have the support of the labor unions, but failure to reduce unemployment could result in labor unrest. Moreover, there is a lack of unanimity within the government over the priority attached to controlling inflation. Almunia and Boyer appear resigned to the proposition that little can be done to prevent rising unemployment without rekindling inflation. Vice Prime Minister Alfonso Guerra, on the other hand, is more concerned about the political ramifications of following a conservative policy. In the short term, Almunia and Boyer probably will have their way. By the end of the year, however, domestic pressure for more expansionary policies—particularly from the Socialists' working-class constituency—probably will be too strong for the government to ignore. Government leaders will be hoping in the meantime for a worldwide economic recovery strong enough to allow them to ease their policies somewhat without doing serious damage to the balance of payments.

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Protectionist Trends in Developing Countries

Most LDCs continue to rely heavily on import barriers to protect local industries from foreign competition. Although the levels of protection remain high, they tend to rise and fall with the countries' foreign financial positions. Recently, many LDCs have raised barriers to deal with burgeoning debt problems. There are a few exceptions. The more dynamic exporters such as South Korea and Taiwan have steadily eased barriers since the late 1970s.

Developed nations have accepted the LDC need for protection for both "infant industry" and financial reasons. In GATT negotiations, for example, LDCs benefit from all developed country trade liberalization on a most-favored-nation basis, but they are not obligated to extend reciprocal concessions. In practice, many LDCs have interpreted their exemption from selected GATT obligations as a license to maintain restrictive import regimes. Although arrangements between LDC debtors and the IMF for financing packages customarily include trade liberalization objectives, all parties recognize that a reduction in protectionism will be possible only in later stages of economic recovery.

Trade Policies of Selected LDCs

Argentina. Argentina's military government liberalized the country's traditionally protectionist import policies over the last several years, but strict import control measures imposed during the April 1982 Falklands conflict remain in effect. In April 1982 a licensing requirement was imposed on all imports, and in May nonessential imports, including most consumer goods, were banned. Before the Falklands conflict, only about 200 items—primarily machinery and equipment—required licenses. Banned items had been reduced from 700 in 1975

to a handful in early 1982. As is currently the case in other countries with severe payments problems, issuance of import licenses may depend on foreign exchange availability, administrative determination of need for the import, or the influence or pressure an importer can exert on government officials.

Brazil. Brazil's import policies have become considerably more restrictive in the past year in response to its balance-of-payments problems. About 1,900 items—largely chemicals, pharmaceuticals, and machinery—were added to the list of banned imports, which consisted mostly of luxuries and nonessential goods. The ban, however, does not apply to imports from other Latin American Integration Association members. Private firms are now being required to cut imports by 5 percent on top of the announced 10-percent cuts imposed in July 1982. State-owned firms have been forced to cut back as well. In addition, the Foreign Trade Department of the Bank of Brazil is supposed to be clamping down on import licenses.

India. India began to liberalize its import policy slightly in the late 1970s when its foreign exchange position was comfortable. Licensing—the main vehicle for controlling imports—has been simplified. Raw materials and components may be imported relatively easily, and the government now tolerates limited import competition for domestic manufacturers. Exporters receive special consideration in the granting of import licenses. Nevertheless, imports of most consumer products are still prohibited, and New Delhi views import substitution in petroleum, fertilizer, steel, and cement as a major aspect of its economic policy. Moreover, India now faces a huge foreign trade deficit, and higher tariff rates were announced last December and again this

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Automotive Import Barriers:
An Illustration of LDC Protectionism

To stimulate industrialization and create employment, most advanced developing countries maintain extensive barriers to automobile and truck imports. Barriers include tariffs, quotas, and import licensing requirements, as well as harsh local content rules. These policies have forced US, Japanese, and West European manufacturers to establish manufacturing and assembly facilities or joint ventures in many LDCs in order to participate in local markets. Local content rules for selected LDCs are as follow:

Argentina	96-percent local content rule—a virtual import ban—was being liberalized before the 1982 import clampdown, with some auto imports and exchanges of components between domestic and foreign plants allowed.	Mexico	50-percent local content required for cars, 65 percent for trucks, but recommended levels are 75 percent and 85 percent.
Brazil	Autos must be 99-percent Brazilian by value. Rules include partial or total bans on imports that compete with domestic components.	Peru	30-percent local content required.
Chile	1973 local content rule of 70 percent has been phased down to 15 percent. Auto consumer tax and tariff had also been falling until this year.	Venezuela	55-percent local content required, rising to 59 percent in 1985. Producers can satisfy part of requirement by exporting.
Colombia	Stated goal is 25-percent local content, but parts imports are denied only when local product is competitive.	India	Local sourcing required whenever possible.
		Indonesia	Generally required to use local components whenever available. Japanese firms have exploited this by establishing affiliated parts makers.
		Philippines	Tariff breaks on unassembled vehicles promote local labor content.
		South Korea	Usually required to use local parts when available. The government pressures foreign firms to develop local sourcing.
		Thailand	50-percent local content will be required later this year.
		Morocco	14-percent local content is required for autos, 21 percent for trucks. May be increased. []

February. New Delhi may be tempted to tighten import controls when its annual import-export policy is announced in April, but it presumably would have to convince the IMF that such moves would not violate the conditions laid down for further disbursements of the Fund's \$5.7 billion loan. []

Mexico. Last September Mexico substantially raised import barriers in response to the mounting financial crisis. Licensing requirements were imposed on all imports, and only food and capital goods may be imported at the controlled exchange rate. The emergency measures reversed a program begun in 1977 to remove import licensing requirements from a large number of items and replace

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them with higher tariffs, thereby improving the predictability of import regulation.

the de la Madrid government is beginning to take a more practical approach on import policy and is allowing exceptions to the import licensing rules where controls have hurt efficiency and hindered investment.

some operations are unable to import needed supplies because of limited foreign exchange availability.

Nigeria. Before Nigeria's current financial difficulties, import restrictions were very limited. The few items that did not enter freely were controlled through licensing and import bans—such as those on goods coming from South Africa and Namibia. In April 1982, however, licensing requirements and import bans were broadened significantly, and import deposits from 25 to 250 percent of the value of the import were required. Additional restrictions announced in January added 150 general categories to the import licensing system, thereby including all remaining significant imports. Lagos also raised tariffs substantially—some to 175 percent—while reducing compulsory import deposits.

Philippines. With Philippine accession to GATT in 1980, Manila instituted a four-year program of tariff and import license liberalization. A World Bank structural adjustment program begun in 1981 has also resulted in liberalization of trade and foreign exchange controls. Some items are no longer restricted, and 960 of 1,300 restricted goods are being liberalized over three years beginning in 1981. Average tariffs have been reduced from 42 percent in 1978 to 28 percent at present. Nevertheless, in response to its worsening payments position, Manila in January imposed a 3-percent surtax on all imports and required that duties and taxes be paid when opening letters of credit. Imports used in the production of exports are exempt.

South Korea. South Korea is much less protectionist than most developing countries. In 1979 Seoul instituted a plan to liberalize 90 percent of South Korean import classifications by 1986. Tariffs were

cut 11 to 25 percent in 1979 and are now around 5 to 10 percent for raw materials, 20 to 30 percent for capital goods, and 50 to 60 percent for finished goods. Uncompetitive domestic industries, producers of strategic items, and many agricultural producers will continue to be protected, but rules for machinery, electrical and metal products, petrochemicals, and products in which South Korea is internationally competitive have been or are scheduled to be liberalized.

Taiwan. Taiwan has been steadily easing its import restraints over the past several years. In 1979 the government stated its intention to drop tariffs to levels maintained by developed countries, and the following year announced plans to drop average tariffs from 32 to 13 percent by 1983. Priority was given to cutting tariffs on raw materials and capital goods not produced in Taiwan. Although all imports require licenses, about 97 percent of all categories are licensed automatically and can be imported subject only to the availability of foreign exchange. The remaining items, primarily luxuries and consumer goods, are controlled to protect domestic industries; licenses for them are granted on a case-by-case basis.

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Venezuela. Venezuela's traditionally protectionist stance toughened substantially in January of this year. Two hundred agricultural and industrial products were banned for balance-of-payments and competitive reasons, and tariffs, already high on consumer goods, were increased. Import licenses were made mandatory on 565 new items, including foods, auto parts, and construction materials. Also in response to the payments crisis, the Venezuelan Government announced foreign exchange controls in February, with only imports of essential goods qualifying for foreign exchange at the preferential rate. Press reports quote a Colombian Andean Pact official as saying the actions could cut pact trade with Venezuela in half this year. In response, Venezuela has attacked other members' nontariff barriers that harm Venezuelan exports.

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The Philippines: Economic Decisionmaking

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Manila is in the midst of its most thorough overhaul of economic policy since the 1950s—a two-track effort designed both to cope with the current global recession and restructure the economy over the long run. Economic policy currently is the product of a decisionmaking framework created by constitutional amendments of President Marcos's own design that closely followed the dismantling of martial law in January 1981. The Philippines's economic decisionmaking system has been geared to striking a politically acceptable balance between the views of Western-educated technocrats, creditors such as the IMF and the World Bank, and influential domestic business interests. The balance currently favors the technocrats and creditors, chiefly because Marcos recognizes that the economy is in its worst shape in a decade. Though it is often difficult to tell how actively Marcos is involved in the economic policy process, we are certain that all major decisions require his approval.

strong inclination toward nationalism mark the technocrats' intellectual makeup. All recognize the strength of market forces in designing policy and each has earned a reputation for honesty and expertise.

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Policy planning and coordinating mechanisms headed by the technocrats are being strained by the recent growth of government. The Monetary Board, chaired by Virata with representation from most ministries and government agencies, meets weekly to plan financial policy. Its management of the foreign borrowing program is well above Third World standards, but the expansion of foreign borrowing since 1980 has sometimes placed too many loans in the international capital market at once, making potential lenders nervous and occasionally aborting the borrowing plans of state agencies. The board's efforts to develop local capital markets by reforming financial regulations have sometimes been at odds with growing government deficits, which have soaked up an increasing share of national savings even as reforms were implemented to stimulate savings. Economic nationalism has also compromised financial planning by limiting the role of foreign investment in the Philippines.

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The Technocrats' Performance

Manila's present staff of technocrats rose to positions of prominence during the financial crisis of 1981 when the collapse of the domestic commercial paper market left the private sector without short-term financing and the existing government decisionmaking apparatus with severely damaged credibility both at home and abroad. Best known among them is a group respectfully referred to within government as "the gang of four"—Prime Minister and Minister of Finance Virata, Central Bank Governor Laya, Minister of Trade and Industry Ongpin, and Planning Minister Mapa. A background of training in US graduate schools and a

The budget process has become unwieldy and has yet to adapt to the recent growth of public-sector investment spending. In the early 1970s, capital expenditures constituted only 10 percent of the national budget, and the role of the state enterprise sector was relatively small; capital spending took 30 percent of total government outlays in 1981, according to the World Bank. Last year, ministries and state corporations prepared individual capital budgets that exceeded available resources by over 65 percent, according to reports published by the

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The Philippines:
Key Institutions in Economic Policy Formulation

Institution	Remarks	Institution	Remarks
Decisionmakers Within Government			
Key Ministries			
Central Bank	Most powerful single institution in influencing the direction of the economy. Generally favors conservative monetary policies and exchange rates that somewhat overvalue the peso. Philippine equivalent to the US Federal Reserve. Along with other ministries, advocates free-market policies with selected price-distorting mechanisms that favor domestic entrepreneurs.	Office of the Prime Minister	Has acquired much of palace's decisionmaking machinery since 1981. Incumbent an advocate of market-oriented economic policies, but strongly nationalistic.
Ministry of Finance	Has supported expansionary spending policies. Equivalent to the US Treasury.	The Executive Committee	Considers largely technical matters according to agenda forwarded from President through Prime Minister.
Ministry of Energy	Among the most favored ministries in the budget.	The National Assembly	Essentially a rubber stamp, completely dominated by ruling party apparatus. Nonetheless plays more active role in discussion of policy than several years ago.
Ministry of Agriculture	Least influential single ministry.	Domestic Think Tanks and Business Institutions	
Ministry of Labor and Employment	Manages overseas employment programs and domestic industrial relations. Industrial relations policy debated by tripartite government, business, and labor groups in a highly publicized manner atypical of other policy issues.	The Center for Research and Communications	A privately funded policy analysis and forecasting group without formal ties to the government. Exercises some influence on government through its ties to private investors and informal links to the technocrats, but under political pressure has reportedly tailored some of its judgments to what the government wants to hear. Headed by Harvard-trained economist Bernardo Villegas.
Ministry of Human Settlements	Run by Imelda Marcos. The Philippine equivalent to the US Department of Health and Human Services.	SGV Accounting (SyCip, Gorres, and Verrano)	A financial consulting and accounting firm; trained Laya, Virata, Ongpin, and other technocrats in the practicalities of financial management. Not an active advocate of a particular economic strategy, we believe its alumni nonetheless are imbued with a bias against multinational corporations.
Ministry of Trade and Industry	Functions sharply expanded in recent years.	The Makati Business Club	A loose conglomeration of business interests, including several opposed to Marcos. During the summer of 1982, conducted a public reexamination of economic policy, calling for far-reaching changes amid charges of a "crisis of confidence" in government. Headed by Enrique Ayala-Zobel, an oligarch whose wealth predates the Marcos era.
Coordinating Bodies			
The Monetary Board	Financial coordination: foreign and domestic government borrowing, monetary and exchange rate policy. Chaired by Virata.	The Philippine Chamber of Commerce and Industry	Key lobbying group of local business interests. Vigorously opposed to economic restructuring program. Advocates discretionary assistance to the private sector. Headed by Fred Elizalde, an industrial oligarch with ties to the President.
National Economic Development Authority, (NEDA)	Coordinates long-term planning. Weaker institution than several years ago. Advocate of high interest rates and small budget deficits as a technique of balance-of-payments management. World Bank and IMF restructuring program advocated for a decade by NEDA before being implemented as policy in 1980.		
Overall Policy Design			
Office of the President	Decides all matters of consequence, channels issues to other institutions via Executive Committee.		

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World Bank. As for the long-term planning process, the National Economic Development Authority (NEDA), which sets development priorities every five years, and Planning Minister Mapa function largely as coordinators between the Central Bank and key ministries. The coordination process is described by NEDA officials as "consensus seeking" and nonconfrontational. [redacted]

Recent Battles Over Policy

The most widely reported and controversial contest between the technocrats and influential interest groups during the past several years has concerned the coconut levy—a tax on processed coconut that finances a price stabilization scheme. Several financial institutions run by Assemblyman Eduardo Cojuangco administer the program, and the scheme has financed industrial consolidation under an umbrella organization controlled by Cojuangco and Defense Minister Juan Ponce-Enrile. Worried by Communist insurgent gains in the coconut-growing regions in late 1981, Virata persuaded Marcos to drop the levy in favor of higher prices for farmers. Industrial management later prevailed to have the levy reinstated, prompting a threat by Virata to resign. In January 1982 he persuaded Marcos to "float" the levy on a sliding scale dictated by international prices and later in the year succeeded in suspending the levy completely when prices fell further. [redacted]

The traditionally good relationship between the government and its international creditors has been strained during the last year. Negotiations with the IMF for a new standby loan stalled over domestic fiscal policy. Lack of an agreement with the Fund was partly responsible for the deterioration in the Philippines's international credit rating and has held up the second structural adjustment loan from the World Bank. In the face of rapidly deteriorating external accounts, however, Manila early this year capitulated to IMF demands. The \$304 million Fund credit stipulates a comprehensive midterm review of exchange rate management, foreign borrowing, budgetary performance, and

efforts to trim the estimated \$4 billion-plus short-term foreign debt. To ensure Manila complies, the release of most of the funds will be held in abeyance pending satisfactory policy. [redacted]

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The Decade Ahead

Manila's economic policymaking during the 1980s will depend critically on the urgency Marcos attaches to the economic problems and the ensuing political fallout. We believe that the economic outlook over the next several years is poor and that the most formidable tests of Marcos's economic decisionmaking system are just beginning. As a result, the technocrats probably will continue as prominent actors in the policy arena during the next several years, and creditors such as the IMF probably will continue exercising substantial leverage on Manila's decisions. [redacted]

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The system will be tested by two long-term problems that may turn out to be more serious than the slowdown produced by the global recession: demographics assure extremely rapid labor force growth during the 1980s, and the maturity structure of the foreign debt assures continuing balance-of-payments strains. Furthermore, the outlook for important agricultural crops is bleak. [redacted]

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Manila still has basic decisions to make about the direction of policy. These concern the choice between keeping inefficient firms afloat with public money and a more realistic approach to economic policy. No one, including high-level Philippine officials, knows how this dilemma will be resolved. [redacted]

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The technocrats' suggestions have yet to slow the momentum to larger government, however. Government investment in state enterprises, according to Philippine data, reached 5 percent of GNP last year, up from 3 percent in 1978. At the same time, the public sector has significantly expanded its holdings of equity in the private sector because of the technocrats' financial rescue program. Manila thus faces the task in the 1980s of divesting itself of inefficient enterprises if expertise provided by government financial organizations proves insufficient to sort out their problems. A more awkward choice financially may turn out to be whether to divest the public portfolio of sound enterprises, thus resisting the trend to state capitalism.

Marcos's decisionmaking system must also find ways to revitalize the deteriorating rural economy, which will not be able to capitalize on the full effects of recovery in industrialized countries without substantial restructuring. The shift out of sugar and coconut production—a stated objective of government agricultural experts—promises to be retarded by vested interests close to the President. A rural investment program begun in 1981, the \$125 million National Livelihood Movement sponsored by Imelda Marcos, is not sufficient to offset the effects of otherwise weak agricultural policy.

The key indicator of the decisionmaking system's ability to deal with economic and financial strains during the next several years will be management of its single most powerful policy instrument—the foreign exchange rate. Rising debt service obligations and a weak balance of trade will demand more rapid depreciation of the peso than Manila has permitted in the past. The country's estimated \$1.1 billion balance-of-payments deficit for 1982 and the simultaneous failure of the peso to depreciate rapidly against currencies other than the US

dollar are evidence of vigorous Central Bank defense of the exchange rate. Failure to allow sufficient depreciation could produce serious foreign debt management problems by rapidly expanding imports beyond a sustainable level of financing. The IMF has already concluded that the current account deficit, at a record 9 percent of GNP in 1982, was three times the sustainable level.

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